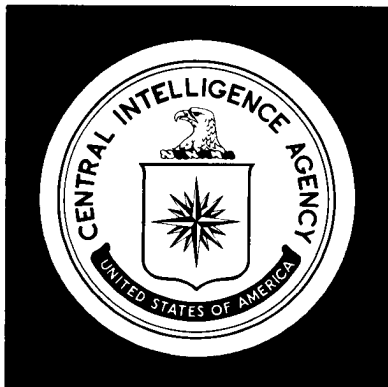


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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

The Current State of the Soviet Economy

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
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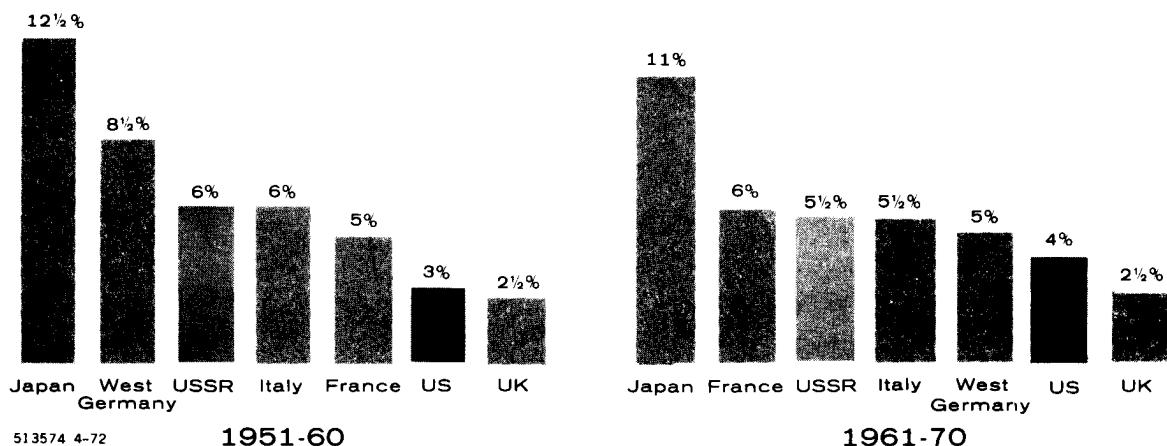
INTELLIGENCE MEMORANDUM

The Current State of the Soviet Economy

1. The Soviet economy, the second largest in the world, is a mixture of strengths and weaknesses. On balance, the leadership feels no economic problem is so serious as to require substantial reforms either in the allocation of resources or in the way the economy is managed. In other words, the regime seems confident that an acceptable rate of economic growth can be maintained, permitting rising levels of consumption for the people as well as providing for a growing military-space establishment and meeting the requirements of modernization.

2. The basis of the USSR's economic strength lies in its great natural wealth, which ensures self-sufficiency in nearly all important raw materials and a trained labor force that is about

Average Annual Rate of Growth of GNP, Selected Countries



Note: This memorandum was prepared by the Office of Economic Research and coordinated with the Office of Current Intelligence and the Office of Strategic Research.

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half again as large as the US labor force. As a result of its emphasis on investment and industrialization, the USSR has maintained rates of growth of GNP that are high, although not exceptional, by international standards. In 1971 the GNP of the USSR reached \$549 billion, about 55 percent of the US level. While building an impressive industrial base, the USSR has been able to achieve near-parity with the US in military strength and to provide substantial increases in consumption levels.

3. To reach the present stage of Soviet economic development, the Soviet leadership has relied on a single-minded strategy--forcing growth by heavy doses of investment. As a result, outlays for investment have taken an increasing share of GNP at the expense of the shares for consumption and military expenditures.

Distribution of Soviet GNP by End Use (Percent)

	<u>1950</u>	<u>1960</u>	<u>1971</u>
Consumption	68	63	59
New fixed investment	12	22	26
Defense (including military space programs)	13	8	6
Other	7	7	9

The large annual additions of new plant and equipment have kept production increasing fast enough, however, so that neither consumption nor defense has suffered. Per capita consumption increased by almost 4 percent per year in both the 1950s and the 1960s. Outlays for defense dropped from the equivalent of \$61 billion in 1950 to \$53 billion in 1960 and then climbed to \$72 billion in 1971.

4. Despite these strengths and successes, the Soviet leadership continues to be concerned about three basic economic problems:

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- Declining growth rates. The Soviet economy grew more slowly in the 1960s than in the 1950s, and the rate of growth is likely to decline further in the 1970s. The goal of overtaking the US economically is as distant as it was a decade ago--the dollar gap between the national products of the two countries increased in the 1960s. Meanwhile, already behind many Western European countries in per capita production, the USSR has now been surpassed in this respect by Japan as well.

- The productivity and technological gap. The fact that the USSR produces about half as much as the US with a labor force 50 percent greater suggests the magnitude of the Soviet problem in this area. The reasons for the relatively low productivity in the Soviet Union are primarily organizational and political: inefficient management practices, a cumbersome planning system, and the overriding priority given to increasing the quantity of production as quickly as possible to the detriment of efficiency and quality. Introduction of new technology and the replacement of old methods of production have been slow, and as a consequence, the technological level in many sectors is substantially below Western levels. Product quality also is a serious problem. Most Soviet manufactured goods, particularly machinery, cannot compete successfully in Western markets.

- Consumer living standards. Although the Soviet population is far better off than it was in the years just after the war, per capita consumption in the USSR is still only one third that in the US, substantially less than in Western Europe, and less than in most East European countries. Soviet consumers are increasingly aware of where they stand in relation to consumers in other countries and are particularly interested in improving the quality of their diet and in acquiring more housing. Perhaps with the 1970

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Polish riots in mind, and realizing the importance of consumption levels for work incentives, the leadership has committed itself to major programs in the consumption area. The most striking evidence of the new policy is the plan to make more meat and consumer durables, particularly passenger cars, available to the people.

Recent Economic Developments

5. Because of fluctuations in agricultural production, the year-to-year growth in Soviet GNP has varied considerably in the past six years--from a low of 2.5 percent in 1969 to a high of 8 percent in 1970. In 1971, GNP increased by only about 3.5 percent, as farm output declined slightly from the record 1970 level and the pace of industrial growth weakened. Per capita consumption also rose at a slower pace than in the preceding five years--4 percent compared with 4.5 percent per year in 1966-70. The results for 1971 reflected a slower growth in the supply of food and consumer durables.

The Industrial Scene

6. Industrial output in 1971 did not measure up to expectations, particularly with respect to consumer goods. Over-all industrial production increased by about 5.5 percent--well below the planned increase for 1971 and the average annual growth of 7 percent achieved during the 1960s. Most of the published production targets were met or surpassed, but substantial declines occurred in some categories of processed foods and consumer durables--notably fish, sugar, television sets, and washing machines. Production of fabrics and shoes also fell short of plan. Moreover, the year was marked by a definite slowdown after mid-year in the rates of growth of all major branches producing industrial materials and consumer goods.

7. The slowdown in industrial growth in 1971 reflects continuing difficulties in achieving satisfactory increases in productivity. Soviet

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industry is plagued by imbalances that are caused by its uneven development and by the relatively low productivity of many of its sectors. Much of the disappointing performance, in turn, stems from inferior and outdated technology. The USSR, for example, produced more steel in 1971 than any other country, but not enough cold-rolled steel for cars or other consumer durables, nor enough large-diameter pipe for the development of its remote oil and gas resources. It turns out more machine tools than any other country, but few of these are of an advanced type, and it must rely on Western firms to equip its new passenger car and truck plants.

8. Because the Soviet management system is so laggard in mastering new technology, the planning authorities tend to adopt "campaign" tactics--to attack technical backwardness in relatively narrow areas. Recently, these have taken the form of enormous investments in the chemical industry (especially fertilizers) and then in passenger car production (the Fiat plant) and truck production (the Kama complex). In priority areas such as these, the USSR has turned increasingly to the West for machinery and complete plants to help close the technological gap between its industry and standard Western practice. Other candidates for Western technical help are the production of numerically controlled machine tools and third-generation computers, where the inferiority of Soviet electronic controls and the lack of know-how in the series production of such equipment has been an obstacle. Another example is the development of the new Siberian natural oil and gas fields, where meeting future goals depends on overcoming problems associated with drilling wells and constructing pipelines in permafrost. In a recent article, Soviet geologists hinted that the development of the gas deposits will not take place as quickly as planned. Any postponement of West Siberian development would result in an under-fulfillment of future plans for exploiting natural gas and could affect domestic supply as well as export commitments to East and West Europe.

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The Agricultural Situation

9. Agriculture is the weakest and least productive sector of the Soviet economy. The system of giant collective and state farms has proved to be the worst managed and least efficient organizational form in the country. Nearly a third of the labor force is still employed on the farm, and the cost of producing grain and meat is far above world market prices. Large increases in farm gate prices and peasant incomes over the last decade have slowed the flight of labor from the farm, but have also raised costs without stimulating efficiency. In spite of the world's largest inputs of labor and investment, the USSR is periodically forced into Western markets for food to provide promised improvements in the diet for the population.

10. Net agricultural production in 1971 declined 1.5 percent as a 5 percent increase in the output of animal products failed to offset a 2.5 percent drop in crop production and a slower growth of livestock herds. Meat production increased 7 percent on the heels of a 5 percent gain in 1970. Net production of grain--estimated at 148 million metric tons--was slightly off the 1970 level, while potato, sugar beet, and vegetable crops all dropped by 5 to 8 percent.

11. Even though farm production in 1971 was near the record 1970 level, the Soviet Union spent roughly \$700 million in hard currency to purchase large quantities of grain, sugar, and meat in 1971 and early 1972. The growing imports of agricultural commodities during two years of abundant harvests indicate the determination of the leadership to upgrade the Russian diet. Per capita consumption of meat and other quality foods in the Soviet Union is still markedly less than in other industrialized countries. As disposable incomes increase on an already determined schedule, consumer demand for meat rises about proportionately. Production of meat and other livestock products has not kept up with this growing demand, and shortages are endemic. The rapid increase in meat production in 1970-71 eased the meat shortage somewhat, but also boosted the requirement for feed grains by 11 million tons, or

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some 25 percent. These demands in turn could not be met from current grain production, and large imports and withdrawals from grain stocks were necessary.

12. This winter the fragility of the USSR's grain and livestock economy has been exposed once again. Severe cold combined with sparse snow cover may have destroyed up to one third of the winter grain crop. While the winter damage can be repaired by resowing and by increased attention to the surviving winter crops and to spring crops, the weather will be a critical factor from now on. Even with average weather, the USSR will probably buy more grain in 1972 in order to maintain the momentum of its meat program and still meet its export commitments to Eastern Europe and other dependent countries.* If the weather this spring and summer turns out to be worse than normal, the possibility of large additional Soviet imports of foreign grain would of course be even greater. If the USSR is forced to import large quantities of wheat this year because of a poor crop, a large share of the imports would have to come from the US. Port facilities in Canada, the major alternative supplier, will be tied up handling existing contracts until the end of 1972.

13. Over the longer term, the USSR probably will be in the market for American feed grains and possibly protein supplements. The feed requirements of the Soviet livestock program will not be met by the USSR's domestic production of grain over the next several years.

**Since June 1971, the USSR has agreed to purchase about 13 1/4 million tons of grain and has taken an option for an additional 1 1/2 million tons. Approximately 8 1/4 million tons are expected to be delivered before July 1972; the remainder of about 5 million tons is to be delivered later. Not all deliveries will be made to the USSR, however. About 350 thousand tons of wheat-equivalent, in the form of flour, will be shipped from Canada to Cuba, and at least 1 million tons of grain will be unloaded in Eastern Europe.*

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The Impact of Military Programs on the Economy

14. As the rate of growth of GNP has outstripped the growth of military expenditures since the mid-1950s, the share of Soviet resources devoted to military programs has fallen steadily--from 13 percent in 1950 to 6 percent in 1971. Because the economy has grown so rapidly, military programs now require only about one tenth of industrial output and one fifth of the production of the machinery sector. In sum, the production capacity of the Soviet Union is now so large that even moderate growth of GNP can support continuing large absolute increases in military spending without undue strain.

15. Thus the short-run economic benefits for the USSR of a brake on the upward trend in military spending are limited and are insufficient by themselves to force the Soviet Union into a SALT-type agreement. The USSR has achieved parity with the US in important military areas, and continued economic growth will permit maintenance of this parity without adding to the share of national resources devoted to military programs. Moreover, the amount of resources likely to be released under the kind of agreement being discussed does not loom large enough in relation to total investment to raise the rate of economic growth appreciably.

16. Although the Soviet Union can afford to spend more on its military programs, this does not mean that the occasional complaints of Soviet leaders about the burden of military programs are meaningless. The Soviet leaders surely would not welcome an escalation of expenditures which might well leave unchanged the relative strength of the two blocs. And in some areas where the civilian economy is backward--such as computers and some kinds of electronics--a release of some of the talent heretofore pre-empted by military research and production would be of substantial help.

Outlook

17. The main objectives of economic policy remain roughly the same as they have been since Khrushchev was sacked. Although the increases in GNP and

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industrial production implied by the 1971-75 plan are larger than the actual increases posted in 1966-70, no major shifts are apparent in the allocation of resources. Brezhnev, Kosygin, and the economic planners recognize that past development relied heavily on rapid growth in the labor force and very high rates of growth of the stock of plant and equipment. The USSR can no longer sustain "extensive" development of this kind; instead, the leadership is now sounding the theme that future growth will depend mainly on "intensive" development--in other words, rapid productivity gains.

18. The 1971-75 plan for industrial growth of 8 percent a year depends heavily on such productivity gains. The technical progress required for these gains, however, is not ensured by any new proposals for achieving them. The USSR must do a better job of using the technology and R&D resources already available to it. Although one impediment to a speedier introduction of new technology in the USSR is organizational, a more fundamental obstacle is political. Party thinking opposes the radical managerial reforms necessary to improve matters, seeing them as a threat to the party's own right of unlimited control. Experimentation with new managerial methods continues--for example, greater use of computers in planning. However, the most striking trend is toward more detailed monitoring of enterprise operations and a greater reliance on party intervention in industrial management. This policy did not work before and is unlikely to be successful now.

19. The alternative source of technical progress--imports of capital equipment from the West--will be crucial for Soviet plans in certain key sectors. Nevertheless, the contribution of foreign technology to growth in 1971-75 will not be extensive. The USSR's foreign exchange position and its reluctance to go too deeply into debt prevent it from importing sufficient plant and equipment to make a major impact across the board.

20. While many of the 1975 goals will probably not be met, the over-all growth of Soviet GNP in 1971-75 should be reasonably satisfactory to the

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leadership--about 5 percent per year. Annual increments in production of this magnitude would provide a steady, visible rise in the population's living standards, very large allocations to investment, and generous support for military-space programs. Neither the five-year plan nor more recent official statements indicate that there will be an appreciable shift in national priorities in the next five years.

21. Nevertheless, there are signs that consumption and consumer-related sectors may now be on a more equal footing with investment and defense. If the economy fails to expand at expected rates in the coming years, resulting in a shortage of resources available for planned programs, growth-oriented sectors, which formerly were protected from cutbacks, may have to suffer along with consumer-oriented sectors. At the completion of the plan, however, the Soviet Union will still find that the consumption levels of its population are much lower than those in most other developed countries and that the lag behind the West has not been appreciably reduced.

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